

**BILL #** SB 1151

**TITLE:** tax credits; withholding reductions

**SPONSOR:** Martin

**STATUS:** As Amended by Senate Finance and Rules

**PREPARED BY:** Jake Corey

## **FISCAL ANALYSIS**

### **Description**

As amended, the bill would allow an employee to request that his employer reduce the employee's Arizona income tax withholding by the amount of the K-12 education tax credit, for contributions to either a public school or a private school tuition organization, the employee plans to claim on his tax return.

### **Estimated Impact**

The bill could result in a General Fund revenue loss beginning in FY 2007 if the option to reduce withholding causes additional public and private school tax credits to be claimed. We can not estimate the magnitude of the impact as it would depend on taxpayer behavior, which is difficult to predict.

Regarding the private school tax credit, new private school scholarships could reduce the state's K-12 education costs if students attend private school who otherwise would have attended public school.

The bill could also result in a one-time FY 2007 General Fund revenue loss to the extent that taxpayers already planning to claim one of the credits reduce their withholding in the first 6 months of Tax Year 2007, which would decrease FY 2007 collections. In FY 2008, however, the tax credit loss would be lessened as the revenue impact was shifted forward into FY 2007.

The Department of Revenue (DOR) estimates that the bill could result in a one-time FY 2007 General Fund revenue loss. The department has not provided an estimate of the total revenue loss.

### **Analysis**

The bill would allow an employee to request that his employer reduce the employee's Arizona income tax withholding by the amount of the K-12 education tax credit the employee plans to claim on his tax return. The employer may reduce the employee's withholding by the amount of the planned credit, but the employer is not required to do so.

A.R.S. § 43-1089.01 allows taxpayers to claim a credit for the amount of any fees paid or contributions made to a public school in support of extracurricular activities or character education programs. The amount of the credit is capped at \$200 for an individual and \$400 for a married couple. According to the most recent data available from DOR, total credits claimed were \$30 million in FY 2004. Allowing a reduction in withholding may result in more taxpayers claiming a credit for a contribution to a public school, as taxpayers would no longer have to wait until filing a tax return to be reimbursed for the cost of the contribution.

A.R.S. § 43-1089 allows taxpayers to claim a credit for contributions made to a school tuition organization. Student tuition organizations are charitable organizations that allocate at least 90% of their annual revenue to private schools for scholarships or tuition grants. The amount of the credit is capped at \$500 for an individual and \$1,000 for a married couple. According to the most recent data available from DOR, total credits claimed were \$31.8 million in FY 2004.

Allowing a reduction in withholding may result in more taxpayers claiming a credit for a contribution to a student tuition organization, as taxpayers would no longer have to wait until filing a tax return to be reimbursed for the cost of the contribution. As a result, these organizations may be able to offer additional new scholarships or increase existing awards to current students. Any loss in state revenues from the additional credits could be offset if it results in new private school

students or students remaining in private school who otherwise would have transferred to public school. It is difficult, however, to quantify all the incentives that factor into private school attendance, as there are both monetary and non-monetary ones.

Beyond the impact on K-12 operating costs, an increase in the amount of private school tax credits claimed could potentially reduce School Facilities Board (SFB) costs for new school construction and building renewal, which could help offset the cost of the tax credit. New school construction costs would decrease if the SFB approved fewer new schools because of reduced enrollment growth under the bill. This would reduce SFB building renewal costs as well because fewer school buildings would require funding under that formula.

Aside from any potential impact on the total amount of credits claimed, the bill could result in a one-time FY 2007 General Fund revenue loss if taxpayers already planning on claiming a credit reduce their withholding in the first 6 months of Tax Year 2007, which would decrease FY 2007 collections. In FY 2008, however, the tax credit loss would be lessened as the revenue impact was shifted forward into FY 2007.

### **Local Government Impact**

The Urban Revenue Sharing formula distributes 15% of income taxes collected 2 years prior to incorporated cities and towns. The bill, therefore, could reduce these distributions beginning in FY 2009 if more credits are taken. In addition, there could be a one-time reduction in FY 2009 if taxpayers shift their withholding in the first 6 months of Tax Year 2007.

Regarding the private school tax credit, K-12 equalization funding to local school districts and charter schools could be lower under the bill than under current law if they serve fewer pupils. Public school enrollment losses under the bill also potentially could reduce the amount of local property tax funding generated by school districts.

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